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Supreme Court of the United States

OCTOBER TERM, 1940

No. 872

313 U.S. #14
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A. B. GOCHENOUR, et al.,

Petitioners,

vs.

GEORGE AND FRANCES BALL FOUNDATION, GEORGE A. BALL and F. B. BERNARD,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITION FOR WRIT OF CERTIORARI AND BRIEF IN SUPPORT THEREOF

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Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITION FOR WRIT OF CERTIORARI

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioners, A. B. GOCHENOUR, ANNA L. LANG, JAMES B. DICK, AUGUST FEINE & SONS COMPANY, ISAAC BARNETT, MULJO HOLDING CO., EVELYN R. LOOK, CHARLES E. KINGSLEY, LOUIS NAPOLEON BUTLER, J. D. DWEES and R. H. JOSSLYN, petition this Court for the issuance of a Writ of Certiorari to review the order of the United States Circuit Court of Appeals for the Seventh Circuit entered January 21, 1941, affirming the order of the

District Court for the Southern District of Indiana, dismissing Petitioners' Complaint for want of jurisdiction.

Statement of the Matter Involved.

Petitioners are a distinct class of creditors who commenced suit in the District Court for the Southern District of Indiana on October 11, 1939, against the respondents, George and Frances Ball Foundation, George A. Ball and F. B. Bernard (R. 1-8). The suit was dismissed for want of jurisdiction on February 15, 1940, on the ground that the cause of action belonged to their debtor, The Cleveland Terminals Building Company, an Ohio Corporation, which is undergoing reorganization under 77B at Cleveland, Ohio, since October 13, 1936. Its voluntary petition was approved on October 15, 1936 and it was allowed to remain as debtor in possession without the appointment of a Trustee.

Respondents are officers, directors and stockholders of Midamerica Corporation which they organized (together with the principal officers of The Terminals Company) on September 26, 1935, for the purpose of purchasing, at a friendly sale, the pledged assets of The Terminals Company for their personal benefit, in fraud of the then existing creditors. They purchased at the price of $318,000.00 (R. 4) assets which yielded them, two years later, over $6,000,000.00 (R. 6). They also purchased at that sale for $887.00 a claim for $13,787,-000.00 against The Terminals Company, and purchased for $2.00 another claim of $1,348,614.99 (R. 32). After they acquired all of these assets and claims they plunged The Terminals Company into bankruptcy under Section 77B, obtained an order against the plaintiffs restraining them from taking any action, and filed these claims seeking to recover the full amount. The Terminals Company, the "Debtor," consented to the allowance of the claims in full (R. 37). Petitioners filed their objections

to the claims and insisted on the appointment of a Trustee. Instead of appointing a Trustee, the Court appointed "special counsel" who later adopted Petitioners' Objections. These claims were allowed for the purchase price of $889.00, and not for the amount of the claims in the sum of $15,135,614.99. In disallowing the claims as requested, the Court found (R. 37):

> (a) That Midamerica Corporation, on September 30, 1935, on the occasion of its purchase of the bonds, the subject matter of the proof of claim filed by it, and thereafter, was a combination in corporate form participated in by the directors of The Cleveland Terminals Building Company, formed and utilized for the purpose, among other things, of divesting The Cleveland Terminals Building Company of its property, and of obtaining claims against said The Cleveland Terminals Building Company at a sacrifice, or at the lowest price possible, for the profit of said combination, at the expense and to the detriment of The Cleveland Terminals Building Company.
>
> (b) that Midamerica Corporation purchased the bonds, the subject matter of its proof of claim, at the auction sale held September 30, 1935, at the sum of $2.00 for the claim of $1,348,614.99, and $887.00 for the claim of $13,787,000.00.
>
> (c) that The Cleveland Terminals Building Company was insolvent in September 30, 1935, and that it could not meet its obligations as they fell due.*

No action was taken by the Debtor (which stood in the capacity of Trustee for the creditors) to sue the Respondents or any of the parties for the illegal profits which they made out of the purchase of the assets, although the facts were known to it as revealed by the objections to the claim of Midamerica and its assignees, the Respondents herein. The period of limitation for

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* Midamerica prosecuted an appeal from this order which is now pending in the Sixth Circuit.

such a cause under the Ohio Law expired September 30, 1939 (R. 41).

Petitioners filed their main suit in the Federal Court at Cleveland on September 11, 1939 (a few days before the expiration of the period of limitation) against Midamerica and its officers who resided in that District (R. 18). They asked for leave to join the Debtor as a party but the Bankruptcy Court denied such leave on the ground that it was not alleged in the Complaint that it was a necessary party (R. 29).

The Complaint (R. 1-8) was founded on the doctrine that the principal officers of the Debtor were trustees for the plaintiffs as creditors, because of the insolvency of the Debtor at the date of the sale. They, the officers, owed a fiduciary duty to the creditors to inform them that the corporation was insolvent and was unable to bid at the scheduled sale, and to give the creditors the opportunity to protect their rights. It was based on the theory that the officers were accountable directly to the creditors as *cestui que trustants,* and that the Respondents who received their profits out of a combination with such unfaithful trustees were equally liable with them directly to the plaintiffs. While the original suit was filed as a class suit for the benefit of all creditors it was amended (R. 11) so as to seek relief for the distinct class of creditors who had no knowledge of the insolvency and of the scheduled sale, to the exclusion of creditors who were not defrauded, including therein J. P. Morgan & Co., a creditor in excess of $27,000,000.00, and the Van Sweringen Corporation, the parent of the Debtor, a creditor for a like amount, who were not defrauded (R. 11, 12). The Amendment stated that the suit was filed only "for the benefit of the plaintiffs and the other creditors who had no knowledge of the facts pertaining to the acquisition of the collateral."

Respondents moved to dismiss the cause of action (R. 9) on the ground that the right of action belonged to the Debtor and that the Bankruptcy Court at Cleveland which administered its property under Section 77B had exclusive jurisdiction. On February 15, 1940, the District Court rendered a decision (R. 42-60) sustaining the position of the Respondents, and it entered an order on February 24, 1935, as of February 15, 1935, dismissing the cause of action for want of jurisdiction. An appeal was taken to the Seventh Circuit, and the Statement of Points presented to that Court urged the following (R. 61):

> 1. The cause of action is predicated upon a wrong done to the plaintiffs who stand in a particular class of creditors and which is not common to all creditors. The plaintiffs are therefore the proper parties to assert a cause on behalf of themselves and the particular creditors who are similarly situated.
>
> 2. The cause of action is not an asset of the bankruptcy estate, and this suit did not interfere with the administration of the Debtor's estate under the 77B proceedings.
>
> 3. The District Court in charge of the 77B proceeding had adjudicated that the Debtor was neither a proper, necessary or indispensable party, and its adjudication was binding upon the court.
>
> 4. The Statute of Limitations having intervened, and there being no possible chance for the Debtor's estate to maintain any cause of action, it was a gross error to dismiss the proceedings, thus defeating a substantial recovery to the plaintiffs and those who are similarly situated.
>
> 5. The capacity of the plaintiffs to maintain the action must be raised by an answer and not by a motion to dismiss, and the Court erred in sustaining the motions to dismiss.

The Seventh Circuit rendered an opinion on January 21, 1941 (R. 70) without discussing any of these points

but simply adopted the decision of the District Court which was published in 35 F. Supp. 508 as its decision, and entered an order affirming the judgment of the District Court (R. 71).

Questions Presented.

The points which were presented to the Seventh Circuit and which it failed to discuss, are the same points on which Petitioners rely in seeking a review here, and such points present the following questions:

1. Whether an action for fraud which is available to a distinct class of defrauded parties, not common with other creditors or stockholders, passes to a Debtor in possession in its capacity as Trustee in Bankruptcy so as to deprive the defrauded parties of their right to maintain an action in their name against the persons who defrauded them.

2. Whether a claim for fraud committed by third parties to a distinct group of creditors is an asset of a Debtor undergoing reorganization under Section 77B, particularly when such Debtor took no action to bring this asset under the administration of the Court and the statutory period of limitation had expired.

3. Whether the denial by a Bankruptcy Court of the request to join the Debtor as a party to proceedings commenced by creditors against third parties for fraud, constituted an adjudication that the cause of action did not belong to the Debtor, or a relinquishment of such exclusive jurisdiction in favor of such creditors.

4. Whether a Bankruptcy Court may on the one hand be said to have exclusive jurisdiction of a cause of action and permit a Debtor in possession, which stands in the position of Trustee, to remain passive without taking any action to bring such assets to the Bankruptcy Court until the intervention of the statutory period of

limitation and at the same time prevent creditors from pursuing their remedies to recover such assets for their own benefit.

Reasons for the Allowance of the Writ.

1. The decision of the Seventh Circuit that a cause of action for fraud, available to a distinct class of creditors against third persons, passes to a Debtor in possession in its capacity as Trustee under Section 77B, is in conflict with the decision of the Ninth Circuit in *Hirschfeld* v. *McKinley,* 78 F. (2) 124 and with the decisions of the Second Circuit in *Babbit* v. *Read,* 236 Fed. 42 (certiorari denied 243 U. S. 648); *Harwood* v. *U. S. Shipping Board,* 32 F. (2) 68, and *Re 1775 Broadway Corporation,* 82 F. (1) 186. It cannot be reconciled with the decision of the Fifth Circuit in *Conway* v. *Bonner,* 100 F. (2) 786, certiorari denied 307 U. S. 632. It is also inconsistent with its own decision in *Re Diversey Building Corporation,* 86 F. (2) 456.

2. It is not the purpose of the Bankruptcy Law to furnish immunity to wrongdoing by corporate officers. A Bankruptcy Court may not apply the doctrine that the rights of creditors pass to a Debtor in possession and permit it to sacrifice the cause of action and at the same time prevent the creditors from suing in their own right within the statutory period.

3. The Writ of Certiorari should issue in order to bring harmony in the conflicting decisions of the various Circuits on important Federal questions in the administration of the Law of Bankruptcy under Section 77B as well as under Chapter X of the present Act.

Prayer for Relief.

Petitioners therefore pray that a Writ of Certiorari be issued to review the judgment of the United States Circuit Court of Appeals for the Seventh Circuit made